Chapter 13 Foreign Dividends

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Section 13.1 Deduction For Foreign Dividends

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References:

Revenue & Taxation Code §24411 (pre- and post-1/1/96)
Revenue & Taxation Code §25110
Revenue & Taxation Code §25106
Revenue & Taxation Code §24344
California Code of Regulation §24411
California Code of Regulation §25110
California Code of Regulation §25106
California Code of Regulation §24344

Training Objectives:

After reviewing the material in this section the reader will be able to do the following:

1. Understand the purpose of RTC §24411
2. Differentiate between partially and fully excluded qualifying dividends
3. Understand the effects of corporate reorganizations upon the RTC §24411 dividend deduction.

a. Introduction

Section 24411 of the Revenue and Taxation Code allows taxpayers, which have elected to compute their income on a water's-edge basis, a deduction with respect to certain qualifying dividends.

Inherent with electing water's-edge, a domestic parent must generally report as income the dividends received from any foreign subsidiary that is excluded from the water's-edge combined report. Since the foreign subsidiary is excluded from the water's-edge group, the dividend would not be eliminated as an intercompany dividend and no apportionment factors corresponding to the income would be included in the formula. Domestic parents argued that such dividends were "foreign source" income and that their inclusion in the combined report effectively taxes the operations of their foreign subsidiaries.

A foreign parent, on the other hand, generally may exclude all of its foreign source income. Although it may receive dividends from subsidiaries not included in the water's-edge combined report, the income would generally not be considered by California since the foreign parent and the dividend payers are excluded from the water's-edge group. Therefore, RTC §24411 was intended to offer relief to domestic parent corporations for this perceived inequity.

INCOME YEARS BEGINNING PRIOR TO 1/1/96

For income years that begin prior to January 1, 1996, generally the deduction is 75 percent of qualified dividends although the amount allowed may vary from year to year. The computation takes into consideration domestic versus foreign activity. The deduction is increased as foreign activity decreases and decreased as foreign activity increases. The calculation of the dividend deduction is mechanical and requires adequate records of the base period (generally 1986, 1985 and 1984) dividends and foreign payroll. The burden of proof falls on the taxpayer and the calculation becomes more complicated when corporations enter or leave the water's-edge group through reorganizations or liquidations.

INCOME YEARS BEGINNING ON OR AFTER 1/1/96

In 1996 legislation (SB 38, Stats 1996, Ch. 954) was enacted which simplified the computation of the RTC §24411 foreign dividend deduction. Effective for income years beginning on or after January 1, 1996, RTC §24411 was amended to allow a flat 75% deduction for all qualifying dividends received, except that dividends resulting from specified construction projects still are 100% deductible. The rules regarding base period amounts and foreign payroll factors that determine the amount of the allowable dividend deduction were repealed.

b. Definitions

1. Base Period

The base period rules are applicable when computing the RTC §24411 dividend deduction for IYEs beginning on or after January 1, 1988 and before January 1, 1996.

The base period consists of the last 12-month income year that ended immediately prior to January 1, 1987, plus the two immediately preceding 12-month income years. If there are not three 12-month income years, the base period will include only the number of full 12-month income years that did exist.

Example 1:

Corporation A has an income year-end of August 31. Its base period would consist of the income years ended August 31, 1986, August 31, 1985 and August 31, 1984. Assume Corporation A began doing business on June 17, 1984. The base period would then consist of only the income years ended August 1986 and August 1985.

When computing the RTC §24411 deduction for income years beginning on or after January 1, 1996, the base period rules are no longer applicable since RTC §24411 was amended.

2. Qualifying Dividends

Qualifying dividends are those dividends received by any member of the **current** water's-edge group which are paid by a corporation which, (a) has an average property, payroll and sales factor within the United States that is less than 20%, **and** (b) has more than 50 percent its total voting stock owned directly or indirectly by the receiving water's edge group at the time the dividend is received.[1]

Note that Section 24411 of the Revenue and Taxation Code states that the dividend must be received from a corporation. For income years beginning on or after 1/1/98, dividends received from banks will also qualify.[2]

The dividend payor need not be unitary with the recipient of the dividend nor any other member of the water's-edge group. The fact that the stock of a dividend payor in a current year was not owned during the base period will not affect the classification as a qualifying dividend.

Example 2:

Corporation A owns 100% of Corporation B, which owns 100% of Corporation C. Corporation C pays Corporation B dividends in 1988 of $120,000. The dividend is paid out of current earnings and profits. Corporations A, B and C are engaged in a unitary business. Corporations A and B file a combined report, making the water's-edge election effective January 1, 1988. Corporation C is incorporated outside of the United States, does no business in the United States, and was excluded from the water's-edge group since its average property, payroll and sales factor was below 20%. The dividends of $120,000 paid to Corporation B are considered to be "qualified dividends".

Example 3:

Further assume that Corporation C, in example 2 above, owns 100% of Corporation D, which is also unitary with Corporations B and C. Corporation D is also incorporated outside of the United States and does no business in the United States. The water's-edge election encompasses only Corporations A and B; Corporations C and D are properly excluded. In 1989 the following dividends are paid: Corporation D pays Corporation C $50,000 of dividends; Corporation C pays dividends of $100,000 to Corporation B; and Corporation B pays Corporation A dividends of $125,000. (All dividends are paid out of current earnings and profits).

The dividends paid to Corporation C are not considered qualifying dividends since Corporation C is not a member of the water's-edge group. The dividends paid to Corporation B are considered qualifying dividends. Lastly, the dividends paid to Corporation A are eliminated pursuant to RTC §25106, intercompany dividends paid from unitary income.

Summary of Example 3:

UNITARY BUSINESS:	TREATMENT…
DOMESTIC TO DOMESTIC:Dividends Paid:B to A - $125,000	Eliminated under RTC Section 25106
FOREIGN TO DOMESTIC:Dividends Paid:C to B - $100,000	Qualifying under RTC Section 24111
FOREIGN TO FOREIGN:Dividends Paid:D to C - $50,000	Not Considered

REQUIREMENTS OF QUALIFYING DIVIDENDS

This summarizes the requirements necessary to qualify as Section 24411 qualifying dividends.

THE DIVIDEND PAYOR:

- Must be owned over 50% by members of the water's edge group
- Must not have more than 20% average apportionment factors in the United States
- May or may not be incorporated in the United States
- May or may not be unitary with member receiving the dividend.

3. Base Period Qualifying Dividends

The base period qualifying dividends rules apply when computing the §24411 dividend deduction for IYE beginning on or after January 1, 1988 and before January 1, 1996.

For IYE beginning on or after January 1, 1996 the base period rules no longer apply due to the amendment to RTC §24411.

Base period qualifying dividends are those dividends, meeting the definition of qualifying dividends above, that were received by members of the **current water's-edge group during** the base period.[3] For this purpose, the 50% ownership test is applied by looking to direct or indirect ownership by the corporations which are members of the current water's-edge group.

The fact that the stock of a dividend payor during the base period is not owned in the current year or that such entity pays no dividends in the current year will not disqualify the dividend as a base period qualifying dividends. Nor does the fact that these dividends may have been eliminated in prior years pursuant to RTC §25106 disqualify the dividend as a base period qualifying dividend.[4]

Example 4:

Corporation E received $8,000, $11,000 and $6,000 in dividends in its December 1986, 1985 and 1984 years, respectively. Of these dividends, Corporation E received dividends of $6,500, $9,800 and $5,400 from affiliates whose average property, payroll and sales factor within the United States was 11%. These affiliates, whose income and apportionment factors were included in the worldwide combined report, were owned 54% indirectly by Corporation E.

Corporation E's base period qualified dividends are $6,500, $9,800 and $5,400.

4. Base Dividends

Base dividends are the largest total amount of base period qualifying dividends received in a single 12-month income year.[5]

Example 5:

Using the same facts as Example 4, Corporation E's base dividends are $9,800, the greatest of $6,500, $9,800 and $5,400.

5. Factors Within The United States

Property, payroll and sales factors within the United States are generally computed pursuant to the rules of each of the individual states. Each corporation will sum the percentage calculated for each factor under the rules of each of the individual states.[6]

If, however, the corporation has activity in a state that does not impose an income tax, or that does not use one of the three factors, then California's rules and regulations apply in determining the amount of any factor not used by the state. In computing the sales factor, sales made by a corporation to any member of the water's-edge group will not be considered in the numerator or the denominator. Further, no item of property, payroll or sales will be assigned in total to more than one state.

6. Foreign Payroll Factor

The foreign payroll factor is a fraction. The numerator is the total compensation paid outside of the United States by the worldwide unitary group (i.e., the entities that would be required to be included in a combined report if the group did not make the waters-edge election). The denominator is the total compensation paid everywhere by the worldwide unitary group.[7]

For purposes of RTC §24411, the United States includes the 50 states of the United States and the District of Columbia. Also, compensation is wages, salaries, commissions and any other form of remuneration paid to employees for personal services. The term has the same meaning as that defined in RTC §25133, Payroll Factor, and the regulations adopted thereto, substituting "United States" for "state" or "this state".

7. Water's-Edge Group

The water's-edge group, for purposes of RTC §24411, is comprised of all banks and corporations includible in the combined report, as determined pursuant to RTC §25110, for the current income year.

8. Adjusted Base Dividend

An adjusted base dividend is the base dividend, as defined above, plus the adjustment as required under RTC §24411(c)(5). The adjustment is the difference between the excess of qualifying dividends over the unadjusted base dividends and the amounts of fully excluded dividends. Adjusted base dividends are illustrated in Example 6 in Section 13.2(b), Water's-Edge Manual.

9. Fully Excluded Qualifying Dividends

Fully excluded qualifying dividends are those qualifying dividends that receive an allowable deduction of 100% and include:

"Subdivision (c) dividends". These dividends are defined by RTC §24411(c) and are fully deductible. These dividends are discussed further in Section 13.2, Water's-Edge Manual.

"Subdivision (h) dividends". These dividends are defined by RTC §24411(h) and are fully deductible. These dividends relate to construction projects whose location is not subject to the control of the taxpayer. **This type of dividend is rare and therefore, not discussed further within this section.**

Note the terms "fully excluded qualified dividends" and "subdivision (c) dividends" are used interchangeably within this section of the training manual.

10. Partially Excluded Qualifying Dividends

Partially excluded qualifying dividends are those qualifying dividends that receive an allowable deduction of 75% and include:

"Subdivision (b) dividends". These dividends are defined by RTC §24411(b) and are partially deductible.

"Subdivision (d) dividends". These dividends are defined by RTC §24411(d) and are partially deductible.

These dividends are discussed further in Section 13.2, Water's-Edge Manual. Note that the terms "partially excluded qualifying dividends" and "subdivision (d) dividends" are used interchangeably within this section of the training manual.

11. Business And Nonbusiness Dividends

When determining the dividend deduction, all qualifying dividends are considered whether the dividends are classified as business or nonbusiness. When the deduction is subsequently determined, the deduction applicable to the business dividends is the total deduction multiplied by the fraction of business qualifying dividends to total qualifying dividends. The remainder of the deduction would then be classified as nonbusiness.

Example 6:

Corporation F had business qualifying dividends of $14,000 and nonbusiness qualifying dividends of $3,000. Corporation F computed its allowable Section 24411 dividend deduction to be $12,750.

The Section 24411 business deduction is $10,500($12,750 @ $14,000/$17,000), while the Section 24411 nonbusiness deduction is $2,250 ($12,750 @ $3,000/$17,000).

c. Classification Of Distributions

California Code of Regulations Section 24411(i) provides that for purposes of determining the application of RTC Sections 24402, 24410, 24411 and 25106, dividends shall be considered to be paid out of the current year's earnings and profits to the extent thereof and from the most recently accumulated earnings and profits by year thereafter.

See Chapter 11, Water's-Edge Manual for a discussion Of Earnings And Profits And Ordering Of Applicable Code Sections pertaining to Dividend Rules.

d. Reorganizations

Activities such as consolidation, liquidation, merger, redemption, purchase or sale of corporate stock, and the purchase or sale of corporate assets will complicate the taxpayer's computation of the RTC §24411 deduction for income years beginning on or after January 1, 1988 and before January 1, 1996. While RTC §24411 is silent on the issue, CCR §24411(h) provides guidance in the area of changes in corporate structure.

This complication will not be present when computing the RTC §24411 deduction for income years beginning on or after January 1, 1996 due to the amendment to RTC §24411 which eliminated the base period rules.

1. Corporation Termination

In those instances when a merger, liquidation or redemption of any corporation in the water's-edge group results in the termination of the existence of that corporation, then the following rules will apply to compute the base period qualifying dividends and base period foreign payroll:

1. base period qualifying dividends will be equal to the total base period qualifying dividends received by all members of the current year's water's-edge group[8], and

2. base period foreign payroll is computed using all compensation paid outside the U.S. during the base period by any currently affiliated bank, corporation, or other entity whose income or apportionment factors were or would have been considered pursuant to RTC §25101 in computing the income of a member of the current year's water's-edge group.[9]

3. In a case where a reorganization or liquidation of the affiliated group results in the termination of the existence of a member of the group, all of its base period qualifying dividends and base period foreign payroll are deemed to be that of its survivor or successor corporation. This mirrors the carryover of tax attributes to the survivor corporation promulgated in IRC §381.[10]

Example 7:

Corporation A is a calendar year taxpayer formed on January 1, 1985, with base period dividends in income years 1985 and 1986. Corporation B, a taxpayer whose year ends on May 31, has base period dividends in the years ended May 31, 1984 and May 31, 1985. B merges into A on May 31, 1985.

The base period dividend of A for the year 1985 includes the dividends which it received and the dividends received by B between January 1, 1985 and May 31, 1985. The dividends received by B between June 1, 1984 and December 31, 1984 are treated as A dividends for the short period income year June 1, 1984 to December 31, 1984. This short period is not a 12-month income year and, therefore, the dividends are not considered in determining base period experience.

2. Divisive Reorganizations

A divisive reorganization occurs when the business operations of a single corporation continue in the form of two or more corporations. When a divisive reorganization has occurred, the base period qualifying dividends and base period foreign payroll is allocated between the surviving entities on the basis of the ratio of the average of the foreign property, payroll and sales factors of the surviving entities computed as if such entities were separate from each other for the income year immediately preceding the reorganization.[11]

3. Purchase Or Sale Of Assets

The purchase or sale of assets does not result in any change to the base period qualifying dividends nor the base period foreign payroll.[12]

4. Purchase Or Sale Of Stock

When the stock of a corporation is purchased or sold the corporation will bring with it, or take with it, its individual base period qualifying dividends and base period foreign payroll.[13]

Under the language of CCR §24411(h)(5), if a taxpayer elects to treat a stock purchase as a purchase of assets pursuant to RTC §24519 (IRC §338), the transaction will still be treated as a purchase of stock for purposes of RTC §24411.[14]

When a sale or purchase of stock results in a corporation being included in the water's-edge group for less than a full 12-month income year, then a pro rata inclusion or exclusion of the base period qualifying dividends and the base period foreign payroll must be made.

Example 8:

Corporation A was acquired by Corporation M, a water's-edge taxpayer, on July 1, 1990. A and M are calendar year taxpayers. A is instantly unitary with M upon acquisition and would be bound by M's water's-edge election as of July 1, 1990 under CCR 25111(d)(2)(C). Both A and M have base period qualifying dividends and base period foreign payroll in 1986. The base period experience of M for the 1986 year will include the dividends which it received during 1986. The base period experience of A will include 6/12ths of the dividends which A received during 1986. M will also include 6/12ths of A's base period foreign payroll in its base period foreign payroll for 1986.

e. Audit Considerations

1. Unity And Intercompany Eliminations

Base period qualifying dividends are those dividends received during the base period by members of the *current* water's-edge group. Therefore, the amount of base period dividends will change depending on which corporations are included in the current water's-edge group. The tax effect of potential base period changes is therefore something to consider when you are deciding whether to pursue a potential unitary examination for income years beginning on or after January 1, 1988 and before January 1, 1996. (For income years beginning on or after January 1, 1996, the base period rules no longer apply.).

Dividends that are paid out of earnings previously included in combined unitary income are eliminated 100% under RTC §25106. This elimination applies only to "intercompany dividends" that are paid out of apportionable business income that was included in a combined report of the dividend payor and payee. In determining whether a dividend is paid out of combined business income, dividends are deemed to be paid first out of current earnings and profits and then out of prior year's accumulation in reverse order of accumulation. A thorough analysis of earnings and profits is included in Chapter 11, Water's-Edge Manual. (See also the Appeal of Willamette Industries, Inc., Cal. St. Bd. of Equal., March 2, 1989.)

Intercompany dividend elimination is at 100%, whereas §24411 dividend deductions are generally only 75%. Therefore, auditors must be alert for dividends that are misclassified as intercompany under RTC §25106 rather than under §24411.

2. Gross-Up Of Foreign Taxes

Internal Revenue Code §78 provides that dividends received from foreign affiliates are "grossed-up" to include income taxes paid on the dividends to foreign countries. The taxpayer can then apply the grossed-up amount in computing its foreign tax credit for federal purposes.

California Revenue and Taxation Code contains no comparable provisions to IRC §78 gross-up nor the foreign tax credit afforded in IRC §902. The amount of gross-up is a separately stated item in the federal 1120, Schedule C.

Therefore, for California purposes, the IRC §78 gross-up is excluded from the combined report. An effort should be made to ensure that this gross-up is excluded from the taxable income of the water's-edge group. Similarly, the gross-up is excluded from current year and base period qualifying dividends.

3. Internal Revenue Code §1248

Pursuant to Internal Revenue Code §1248(a), the gains resulting from the sale of stock in a CFC is treated as a dividend to the extent of post-1962 earnings and profits of that subsidiary and any lower-tier foreign subsidiaries, attributable to that period, and to the extent of the shareholder's percentage of ownership of the sold foreign affiliate.

Thus for federal purposes, these gains, classified as deemed dividends, may allow the seller to claim an indirect foreign tax credit pursuant to IRC §902 for foreign taxes paid or accrued by the foreign affiliate on the earnings included as a dividend.

Except for a limited period of time (discussed below) California Revenue and Taxation Code contains no comparable provision to IRC §1248. Thus an effort should be made to ensure that the taxpayer does not report this gain as an intercompany dividend and eliminate the (federal) deemed dividend pursuant to RTC §25106.[15] For California purposes, the transaction should be treated as a gain on the sale of stock. Note, however, that for income years beginning on or after January 1, 1987 to income years beginning on or after January 1, 1990 for transactions occurring on or before August 20, 1990, California inadvertently conformed to IRC §1248. Therefore, if the transaction occurred during this time period, the federal deemed dividend treatment applies and such amounts will be eligible for RTC §25106 or 24411 treatment.

4. Revenue And Taxation Code §24344(B)

Consideration should be given to the effect of a water's-edge election on the treatment of nonbusiness dividends, and in particular to the interplay with the interest offset provisions. Revenue and Taxation Code §24344(b) does not apply to dividends deducted pursuant to §24411. The interest offset provisions of §24334(c) are applicable to dividends deducted pursuant to §24411. See Chapter 14, Water's-Edge Manual for a detailed discussion of the §24344(c) interest offset provisions.

5. S Corporations

Although S corporations are generally precluded under RTC §23801(c) from being included in the combined report, they can make a water's-edge election and will include 100% of their income in their return.

An S corporation may own controlled foreign corporations (CFCs). Under RTC §23801(c), however, CFCs will not be permitted to file on a combined basis with the S corporation. (See Chapter 2, Water's-Edge Manual for a more detailed discussion of the effects of a water's-edge election on S corporations).

When an S corporation receives dividends from its CFC, the normal rules for dividend treatment for water's-edge taxpayers apply. Dividends paid by the CFC to the S corporation parent will qualify for a deduction under RTC §24411 and will be included in the dividend deduction computation.

f. Summary

Due to the complexity of the §24411 dividend deduction, you should anticipate this issue arising during an audit. In Section 13.2, Water's-Edge Manual, you will review several examples of the dividend deduction computation and work sample problems. After you have completed the review of these two sections, you will be prepared to audit the deduction by understanding the components of the calculation and by using the provided worksheets.

First, you should determine if the RTC §24411 dividend deduction is to be computed for a pre-1/1/96 income year as opposed to IYE beginning on or after 1/1/96 in order to determine if the base year rules will apply.

Also consider the following.

1. The taxpayer must maintain sufficient records to establish the base period qualifying dividends and base period foreign payroll in order to obtain the deduction for pre-1996 income years.
2. The base period consists of three 12-month income years. No short periods may be considered within the base period.
3. Intercompany elimination under RTC §25106 results in more of a deduction than under RTC §24411. Thus, determination of which dividends are intercompany will be critical. (Refer to Chapter 11, Water's-Edge Manual.)
4. California does not conform to federal law with regards to partially included income, Subpart F income, gross-up of foreign taxes, and gains on the sale of stock in a foreign subsidiary. The taxpayer may not be aware of the California treatment of these items.

Corporate reorganizations occur frequently and they will further complicate the calculation for income years beginning prior to January 1, 1996, due to the base period rules.

If a taxpayer is taking a RTC §24411 dividend deduction, the auditor should check to see if the taxpayer has properly calculated the RTC §24344(c) foreign investment interest offset. Chapter 14, Water's-Edge Manual discusses the foreign investment interest offset.

Footnotes

1. CCR §24411(b)(2)(A)
2. In 1997, AB 1040 redefined the term "corporation" in Section 23038 so that the term now includes banks (Ch 605, Stats 1997). The effective dates for that change were contained in the off-code language of the bill, but that language contained some ambiguities. SB 519 (Ch. 7, Stats 1998) later clarified the effective dates. In the offcode language of SB 519, Section 44 states that the statute changes involving the definition of "corporation" generally apply retroactively back to the original effective dates of those statutes. But, offcode Section 45 contains the following exception: "For purposes of the definition of 'qualifying dividends' in subdivision (a) of Section 24411 of the Revenue and Taxation Code, the term 'corporation' shall include banks only for income years beginning on or after January 1, 1998."
3. CCR §24411(b)(3)(A)
4. CCR §24411(b)(3)(B)
5. CCR 24411(b)(4)
6. CCR §24411(b)(5)
7. CCR §24411(b)(6)
8. CCR §24411(h)(1)(A)
9. CCR §24411(h)(1)(B)
10. CCR §24411(h)(1)(C)
11. CCR § 24411(h)(2)
12. CCR §24411(h)(3)
13. CCR §24411(h)(4)
14. CCR §24411(h)(5)
15. CCR §24411(b)(2)(B)

Section 13.2 Computation Of Deduction For Foreign Dividends

Contents:

Worksheets (applicable for computing §24411 dividend deduction for income years beginning prior to January 1, 1996):

a. Introduction

In the last section, you learned the definitions of terms frequently associated with deductible dividends. In this section, you will learn how to compute dividend deductions under various scenarios that you are likely to encounter during an examination of the taxpayer's calculation of the dividend deduction.

After reviewing the material in this section the you will be able to compute the Section 24411 dividend deduction.

For income years beginning on or after January 1, 1988 and before January 1, 1996, the taxpayers claiming a foreign dividend deduction under RTC §24411 filed Form 2411 Water's-Edge Dividend Deduction as part of their California tax return. For income years beginning on or after January 1, 1996, Form 2411 was eliminated, due to the amendments that simplified the RTC §24411 deduction.

Be aware that the mechanics of the RTC §24411 dividend deduction will depend upon which income year is involved, due to an amendment that simplified §24411 effective for income years beginning on or after January 1, 1996.

b. Computation Of Allowable Dividends

1. For Income Years Beginning On Or After 1/1/96

For income years beginning on or after January 1, 1996 the RTC §24411 foreign dividend deduction is:
1. 75% of qualifying dividends, and
2. 100% of dividends from specified construction projects.

The rules regarding base period dividends and base period foreign payroll were repealed when RTC §24411 was amended (SB 38, Stats 1996, Ch. 954). This amendment was effective for income years beginning on or after January 1, 1996.

Example 1:

The taxpayer received $100,000 in qualifying dividends in 1997. The taxpayer is entitled to a Section 24411 dividend deduction in the amount of $75,000 (75% of $100,000).

2. For Income Years Beginning Prior To 1/1/96

For income years beginning prior to January 1, 1996, the deduction itself is mechanical and best understood by simply following examples of the deduction calculation. In simple terms, ignoring various criteria and limitations, the deduction is:

1) 75% of subdivision (b) dividends, and
2) 100% of subdivision (c) dividends, or 75% of subdivision (d) dividends, <u>and</u>
3) 100% of subdivision (h) dividends.

Recall that subdivision (h) dividends, which relate to certain construction projects, are rare. Thus, generally the deduction will include 75% of subdivision (b) dividends and 100% of subdivision (c) dividends, or 75% of subdivision (b) dividends and 75% of subdivision (d) dividends.

Subdivision (b) dividends are the lesser of: 1) the base dividends, or 2) the current year qualifying dividends.

Subdivision (c) dividends are dividends of which: 1) the current year's dividends are in excess of the base period dividends and 2) the greatest foreign payroll factor in any base year is greater than the current year's foreign payroll factor.

Subdivision (d) dividends are dividends of which: 1) the current year dividends are in excess of base period dividends, and 2) the greatest foreign payroll factor in any base year is equal to or less than the current foreign payroll factor.

Example 2:

The base dividends are $150. The current year qualifying dividends are $200. Thus, the subdivision (b) dividends are $150, the lesser of $150 or $200.

Example 2-A:

The base dividends are $150. The current year qualifying dividends are $100. Thus, the subdivision (b) dividends are $100, the lesser of $150 or $100. Subdivision (c) and (d) dividends relate to the excess of current year qualified dividends over base dividends and are illustrated in the examples that follow.

Should the taxpayer meet the criteria to obtain a 100% deduction of subdivision (c) dividends, an adjustment to increase the subdivision (b) dividends may be necessary. This adjustment to the subdivision (b) dividends is illustrated in Example 6. If the taxpayer receives the 75% deduction of the subdivision (d) dividends rather than 100% deduction of subdivision (c) dividends, then no adjustment to the subdivision (b) dividends is allowed.

To obtain a deduction for subdivision (c) or (d) dividends, the **current year's qualifying dividends must be greater than the base dividends.** Whether a corporation can apply the 100% deduction of subdivision (c) dividends or the 75% deduction of subdivision (d) dividends depends on the increase or decrease of the foreign payroll factor.

A water's-edge group that has no base period qualifying dividends or no base period foreign payroll during the base period may still qualify for the Section 24411 deduction. However, if the water's-edge group has neither (both) base period qualifying dividends nor base period foreign payroll, then the water's-edge group is not entitled to the deduction.

Section 25106 intercompany dividends are eliminated before calculating the allowable dividend deduction. No Section 24411 deduction is ever allowed with respect to dividends which have been eliminated from income or otherwise been allowed a deduction. In addition, the deduction can never exceed 100% of the current year's qualifying dividends.

Using Worksheet I through Worksheet VI provided in this section, the dividend deduction can easily be calculated. The worksheets are self-explanatory and proceed through the calculation step-by-step. Use these worksheets to work the following examples.

Example 3:

Corporation N incorporated in California on August 1, 1986. Corporation N owns 100% of Corporation O, and they are engaged in a worldwide unitary business. Corporation N filed a combined report with Corporation O for its income years ended December 1987 and 1986. When Corporation N filed its return for income year ended December 1988, it elected water's-edge and properly excluded Corporation O. Corporation N received dividends of $30,000 from Corporation O in 1988, paid out of the current year earnings and profits.

Does Corporation N qualify for any Section 24411 dividend deduction? If so, how much?

Click here to see the solution for Example 3.

Example 4:

Assume the same facts as in Example 3 except Corporation N incorporated on August 1, 1985. In 1986 corporation N received $40,000 of qualifying dividends from Corporation O. Does Corporation N qualify for any Section 24411 dividend deduction in 1988? If so, how much?

Click here to see the solution for Example 4.

Example 5:

Corporation P began doing business in California on March 11, 1984. Corporation P acquired 100% of Corporations Q and R in October of 1987. Corporation P, Q and R are engaged in a worldwide unitary business. Corporation P filed its return for the income year ended December 1988, electing water's-edge, and properly excluded both Corporation Q and R. Corporation P received from nonunitary foreign affiliates qualifying dividends of $52,000 in the base period. However, during the base period Corporation P did not have foreign payroll. Corporations Q and R had net income in 1988 and paid Corporation P qualifying dividends of $78,000.

Does Corporation P qualify for any Section 24411 dividend deduction in 1988? If so, how much?

Click here to see the solution for Example 5.

Example 6:

Assume Corporation S has qualifying dividends of $7,500, $10,000 and $5,500 for income years ended December 1986, 1985 and 1984, respectively. Corporation S's base dividends are $10,000. The current year's qualifying dividends are $20,000 in 1992. The greatest base period foreign payroll factor is 20%. The current year foreign payroll factor is 15%.

Does Corporation S qualify for Section 24411 dividend deduction in 1992? If so, how much?

Click here to see the solution for Example 6.

Example 7:

Assume Corporation T has qualifying dividends of $7,500, $10,000 and $5,500 for income years ended December 1986, 1985 and 1984, respectively. Corporation T's base dividends are $10,000. The current year's qualifying dividends are $20,000 in 1993. The greatest base period foreign payroll factor is 20%. The current year foreign payroll factor is 25%.

Does Corporation T qualify for Section 24411 dividend deduction in 1993? If so, how much?

Click here to see the solution for Example 7.

Example 8:

Assume Corporation U has qualifying dividends of $175,000, $135,000 and $140,000 for income years ended November 1986, 1985 and 1984, respectively. Corporation U's base dividends are $175,000. The current year's qualifying dividends are $230,000 in 1994. The greatest base year foreign payroll factor is 20% and the current year foreign payroll factor is 20%.

Does Corporation U qualify for Section 24411 dividend deduction in 1994? If so, how much?

Click here to see the solution for Example 8.

Example 9:

Assume Corporation V has qualifying dividends of $75,000, $78,000 and $92,000 for income years ended April 1986, 1985 and 1984, respectively. Corporation V's base dividends are $92,000. The current year's qualifying dividends are $102,000 in 1994. The greatest base year foreign payroll factor is 18% and the current year foreign payroll factor is 13%.

Does Corporation V qualify for Section 24411 dividend deduction in 1994? If so, how much?

Click here to see the solution for Example 9.

Example 10:

Assume Corporation W has qualifying dividends of $102,000, $87,000 and $67,000 for income years ended April 1986, 1985 and 1984, respectively. Corporation W's base dividends are $102,000. The current year's qualifying dividends are $52,000 in 1995. The greatest base year foreign payroll factor is 17%and the current year foreign payroll factor is 17%.

Does Corporation W qualify for Section 24411 dividend deduction? If so, how much?

Click here to see the solution for Example 10.